INFORMED BUDGETEER

PRESIDENT PROPOSES TO CUT MEDICARE TO FUND DISCRETIONARY APPROPRIATIONS

- The Clinton Administration has repeatedly asserted that the President's budget stays within the caps. In fact, according to CBO, the President's proposals break the caps by $30 billion in 2000 alone.

- Moreover, the President's budget would break the caps by even more if he were not including as offsets to discretionary spending a series of cuts in Medicare spending and new user fees on Medicare providers.

- In total, the President proposes $1.8 billion in Medicare reductions in 2000 to pay for his other domestic discretionary spending priorities. Over five years, these Medicare reductions total $13.3 billion, and over ten years they total $31.5 billion.

- Some of the major reductions include:

  - freezing hospital payments in 2000, saving $0.6 billion in 2000 and $8.7 billion over ten years;

  - reducing payments for certain drugs that are covered by Medicare under current law, including cancer treatment drugs, by $0.3 billion in 2000 and $2.5 billion over ten years;

  - charging new fees for provider enrollment in Medicare, initial provider certification by Medicare, provider recertification, paper claims processing, and Medicare+Choice participation, totaling $0.2 billion in 2000 and $4.3 billion over ten years.

- The cuts in provider reimbursement rates will also produce lower payment rates for Medicare+Choice plans, saving $6.9 billion over ten years.

President's Medicare Reductions Proposed as Offsets for Discretionary Spending
$ in Billions

	2000	2000-2004	2000-2009
Freeze Hospital Payments	0.6	3.8	8.7
Clinical Lab Cut	0.1	0.5	1.2
Prosthetics & Orthotics	0.1	0.5	1.3
Hospital Bad Debt Changes	0.4	2.0	4.6
Drug Reimbursements	0.3	1.8	2.5
Partial Hospitalization Cuts	0.0	0.1	0.2
End-Stage-Renal Dialysis Drug	0.1	0.5	1.1
Centers of Excellence	0.1	0.3	0.6
Medicare Secondary Payer	0.0	0.5	1.3
Medicare+Choice Reductions	0.0	2.2	6.9
User Fees	0.2	1.9	4.3
Other/Interaction	-0.1	-0.8	-1.2
Total, Medicare Reductions	**1.8**	**13.3**	**31.5**

SOURCE: CBO

AIR-21: NOT CLEARED TO LAND HERE

- The *Bulletin* has been quiet all year when it comes to H.R.1000, the Aviation Investment and Reform Act for the 21st Century. But with House passage of this bill, it's time the *Bulletin* starts to discuss the flight pattern of this "Spruce Goose".

- This week, we look at aviation revenues and spending. That is, **total** aviation revenues and spending, not just the Airport and Airway Trust Fund. To get the best picture, one must look at **both** trust fund and general fund spending on aviation.

Revenues vs. Actual Spending
($ in billions)

	1998	1999E	2000E
Aviation Trust Fund revenues	8.1	10.2	9.2
Aviation spending	9.1	9.8	- -
Senate proposed 2000 spending*	- -	- -	9.5
House proposed 2000 spending	- -	- -	10.5

SOURCE: CBO, FAA, and House and Senate-Reported Transportation Appropriations Bills. *Senate proposed figure is lower than 1999 due to proposed rescissions of $590M.

- As the chart above details, all aviation excise taxes raised $8.1 billion in 1998 and is estimated to raise $10.2 billion in 1999. This large increase is due not to increased aviation excise taxes. It's due to a timing change created in the 1997 Taxpayer Relief Act. This provision allowed for an extension of the last quarterly payment of aviation excise taxes to Treasury, lowering revenues in 1999 while increasing 1999 revenues.

- When total aviation spending for 1998 and 1999 from both the trust fund and the general fund is combined, the federal government spent $600 million more for aviation than what was collected during this time period.

- This subsidy will grow even higher under the 2000 House and Senate-reported Transportation Appropriations bills. While 2000 revenues are estimated to be $9.2 billion, the Senate bill spends $9.5 billion on aviation. The House is even larger, proposing $10.5 billion in aviation spending for 2000.

- Putting aside the misguided notion that off-budget status and/or firewalls will solve the FAA's problems (more on that later) remember that AIR-21 wants to spend all of the trust fund revenues and force an additional 30 percent of total aviation spending to come from the general fund

- It's too bad the House bill just won't fit into those small airline seats. But the like the rest of us, it will have to fit in the end.

PAY-AS-YOU-GO SEQUESTER REFRESHER (*not* a new tropical drink)

- Under pay-as-you-go, fifteen days after the completion of a session of Congress, OMB is required to add the cost of all direct spending and receipts legislation that has been enacted since the Balanced Budget Act of 1997. If the cumulative effect results in a net decrease to the surplus, OMB is required to make reductions in certain direct spending programs.

- OMB's most up-to-date scorecard is shown below. It shows that Congress could increase direct spending and/or reduce receipts by $2.9 billion in 2000 before OMB would have to implement a sequester. (Note, however, that budget points of order, such as 311 and 302(a), would apply should Congress take such action.)

Sec. 252 Paygo Balances
As of December 31, 1998, $ in millions

	2000	2001	2002	2003	2004	2000- 04
Receipt effect	3696	1778	754	1958	na	8186
Outlay effect	769	945	590	866	na	3170
Net budget impact	-2927	-833	-164	-1092	na	-5016

SOURCE: OMB

- As mentioned in last week's *Bulletin*, the Senate-passed Department of Defense Authorization bill contained a conservative estimate of $15.6 billion in new direct spending over the next ten years - $658 million in the year 2000 alone. If the new direct spending survives conference, we will be that much closer to a paygo sequester.
- Only a small share of mandatory spending is fully subject to a

sequester. Net interest, Social Security, Civil Service and Military retirement, certain low-income, Veterans, and many other smaller programs are exempt from sequester.

- Many other programs are subject to sequester under "special rules" that limit the size of the reductions in those programs. Medicare can be reduced by no more than 4 percent.

- If a sequester is necessary, OMB eliminates the reduction in the surplus through the following steps. First, OMB eliminates the automatic spending increases for the Special Milk and Vocational Rehabilitation program grants.

- If those savings are not sufficient, OMB increases origination fees for student loans by 0.5 percentage point and makes reductions in foster care and adoption assistance.

- If the first two steps are still not enough, OMB reduces Medicare (by up to 4%) and all other non-exempt programs by a uniform percentage necessary to eliminate the surplus reduction.

ECONOMICS

MARKETS EYE FEDERAL RESERVE

- Over the last month, expectations have grown that the Federal Reserve will raise interest rates by 25 basis points at its June 29/30 meeting. This would put the overnight Federal Funds rate at 5.0 percent.

- Such action would reverse a portion of the ease that the Fed instituted last fall during the global financial crisis. Now that global markets have stabilized, the reason for last year's ease has gone.

- A tightening makes sense for a number of other reasons. Goldman Sachs calculates that financial conditions are at their most accommodative position since 1993 -- a time when the Fed was trying to stimulate a languid recovery. (In addition to interest rates and the dollar's value, Goldman also factors the S&P 500 price earnings ratio into their index).

- This may explain why there are few signs that the much-awaited slowdown are materializing. New home sales surged in April, which will underpin consumer spending as families furnish their dwellings. Unemployment has fallen to a 29 year low, and manufacturing surveys continue to show improvement. (While employment growth was weak in May, this reflects seasonal quirks and perhaps the fact that we are running out of available workers).

- Financial markets are worried that such strength will lead to rising inflation now that recent external restraints — like falling commodity prices and an appreciating dollar — have lapsed. That is why the 30-year bond yield surged above 6 percent recently, up substantially from its 5 percent level at the end of 1998. This increase in inflation expectations is also likely to be worrying the Fed.

- Were the Fed to hike rates this summer, it would be in keeping with their actions surrounding the last major financial crisis — the 1987 stock market crash. The effective Fed Funds rate fell roughly 75 basis points during October 1987. However, after financial markets had stabilized, the Fed reversed this ease during the spring of 1988.

YOU TOO CAN HAVE 1.9% QUARTERLY GDP GROWTH WITH $700 BILLION ECONOMIC STIMULUS PACKAGES

- The Japanese government reported unexpected growth in the first quarter 1999 -- real GDP grew 1.9 percent on a quarter over quarter basis -- a remarkable 7.9 percent annualized pace. Consumption and public expenditure made roughly equal contributions to this surge. While some economists concede that the government may now hit its 0.5 percent growth target this year, few believe that first quarter signifies any robust turnaround.

- Public works have made a positive contribution to growth for each of the three last quarters. This has been due largely to the ¥17 trillion stimulus package from April 1998 -- the effects of the ¥24 trillion package in November have yet to be truly felt. However, given the size of recent years' stimulus packages and the still languid nature of Japan's economy, one wonders if these have been cost effective.

- The table below summarizes Japan's economic stimulus packages enacted over the last 5 years. There have been at least 6 stimulus packages, which have grown in magnitude relative to a shrinking GDP.

- As difficult as it might be for U.S. budget analysts to comprehend -- the two 1998 stimulus packages are equivalent to $338 billion. However, when scaled to the size of the U.S. economy (Japanese GDP approximately ½ US GDP) **the 1998 stimulus packages would total nearly $700 billion or 2 and ½ times the Department of Defense budget last year!** Should one be surprised that there was growth in the Japanese economy in the first quarter of 1999?

- The downside -- Japan today has the highest general budget deficits of any industrial country . Excluding the social security surplus (yes Japan has one too), the general government deficit is estimated to have reached nearly 8.0 percent of GDP in 1998.

Japan : Summary of Economic Stimulus Packages
1993-1998, ¥ in trillions

	1993		1994	1995	1998	
	April	Nov.	Feb.	Sept.	April	Nov.*
Total Package	13.2	6.2	15.3	14.2	16.7	23.9
% of GDP	2.8	1.3	3.2	3.0	3.3	4.7
Tax reductions	0.2	0.0	5.9	0.0	4.6[4]	6.0
% of GDP	0.0	0.0	1.2	0.0	0.9	1.2
Public Investment[1]	7.6	2.0	4.5	6.5	7.7	8.1
% of GDP	1.6	0.4	0.9	1.3	1.5	1.6
Land Purchases[2]	1.2	0.3	2.0	3.2	1.6	0.0
% of GDP	0.3	0.1	0.4	0.7	0.3	0.0
Housing Loan Corp.[3]	1.8	2.9	1.2	0.5	0.0	1.2
% of GDP	0.4	0.6	0.3	0.1	0.0	0.2
Govt. affiliated inst.[3]	2.4	1.0	1.5	2.6[5]	2.0	5.9
%of GDP	0.5	0.2	0.3	0.5	0.4	1.2
Other	0.0	0.0	0.2	2.6	0.8	2.7
% of GDP	0.0	0.0	0.0	0.5	0.2	0.5

SOURCES: International Monetary Fund, IMF Staff Country Report no. 98/113, October 1998.*November 1998 data compiled by SBC Staff. [1]Public investment comprises general public works (including land purchases), disaster reconstruction, buildings and equipment, and independent public works projects by local government. [2]Excludes land acquisition for public works projects, which is included in public works spending. [3]Increased lending, includes loans by Pension Welfare Service Public Corporation. [4]Includes -0.3 trillion in welfare benefits. [5]Includes -1.3 trillion in lending by the Japan Corporation for small business.

☞ECONOMIC BULLETIN Makes its debut! The *Bulletin* is pleased to announce a new sister publication: **"The Economic Bulletin"** which will be published monthly by the SBC staff, under the direction of Chief Economist Amy Smith. The Economic Bulletin is now available on the Budget Committee web site.